

**SAGINAW-MIDLAND MUNICIPAL
WATER SUPPLY CORPORATION**
73-7503
Bay City, Michigan

Annual Financial Statements

and

Auditors' Report

June 30, 2004

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended.

| | | | |
|---|-------------------------|---|---------------|
| Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other | | Local Government Name Saginaw Midland Municipal Water Supply Corporation | County Bay |
| Audit Date 6/30/04 | Opinion Date 7/15/04 | Date Accountant Report Submitted to State: 9/16/04 | |

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable boxes for each item below.

- ☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ yes ☒ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ yes ☒ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL: 129/91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

| | Enclosed | To Be Forwarded | Not Required |
|---|-------------------------------------|--------------------------|-------------------------------------|
| The letter of comments and recommendations. | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Reports on individual federal financial assistance programs (program audits). | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
| Single Audit Reports (ASLGU). | <input type="checkbox"/> | <input type="checkbox"/> | <input checked="" type="checkbox"/> |

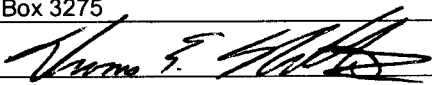
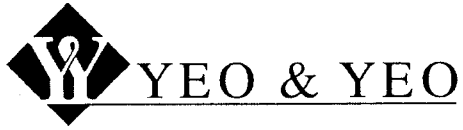
| | | | |
|---|-----------------|-------------|--------------|
| Certified Public Accountant (Firm Name) Yeo & Yeo, P.C. CPAs and Business Consultants | | | |
| Street Address 3023 Davenport P.O. Box 3275 | City Saginaw | State MI | ZIP 48605 |
| Accountant Signature  | | | |

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Independent Auditors' Report

To the Board of Trustees of
Saginaw-Midland Municipal Water Supply Corporation
Bay City, Michigan

We have audited the statement of net assets of Saginaw-Midland Municipal Water Supply Corporation as of June 30, 2004 and 2003, and the related statements of revenue, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the June 30, 2004 and 2003, financial statements referred to above present fairly, in all material respects, the financial position of Saginaw-Midland Municipal Water Supply Corporation as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with auditing standards generally accepted in the United States of America.

The management's discussion and analysis is not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The supplementary financial data identified in the table of contents, although not considered necessary for a fair presentation of financial position, results of operation and cash flows are presented primarily for supplemental analysis purposes.

Yeo & Yeo, P.C.

Saginaw, Michigan
July 15, 2004



MANAGEMENT'S DISCUSSION AND ANALYSIS

The Saginaw-Midland Municipal Water Supply Corporation is presenting the following management discussion and analysis in order to provide an overall review of the Corporation's financial activities for the fiscal year ending June 30, 2004. We encourage readers to consider the information presented here in conjunction with the Corporation's financial statements and notes included with same to enhance their understanding of the Corporation's financial performance.

BACKGROUND

The Saginaw-Midland Municipal Water Supply Corporation (Corporation) for more than 57 years has been reliably providing a high-quality source of Lake Huron drinking water to its owners and customers. The Corporation's annual production is nearing 20 billion gallons with peak days climbing near 100 million gallons. The Corporation operates with three plants and is a bulk supplier of high quality raw water to its owners and customers eventually resulting in service to over 260,000 residents in 30 cities or communities in six (6) Michigan counties. The Corporation's water supply efforts are often referred to as a model illustration of cooperation between two communities for the common good.

The Corporation is the primary government reporting entity even though it is jointly owned by two (2) municipalities, the City of Saginaw and the City of Midland. The ownership ratio of Saginaw and Midland is as follows:

| | |
|-----------------|------------------|
| City of Saginaw | 53.48837 percent |
| City of Midland | 46.51163 percent |

The Corporation is a non-profit municipal corporation operating under Act 233, Michigan Public Acts of 1955.

FINANCIAL HIGHLIGHTS

- The Corporation's total assets decreased \$797,177 while total liabilities decreased \$1,059,412 resulting in total net assets increasing \$262,235 or 1.76% over the course of the year's operations.
- The Corporation's operating expenses in 2003-2004 were \$175,261 higher than 2002-2003 expenses. Most of the increase was due to the retirement of the Manager, an overlap of managers during training, and increased labor related expenses.
- The Corporation's revenue from water sales to its commercial wholesale raw water customers remains relatively constant. The total volume of water sales to these

customers aggregated over 224 million gallons, or less than two (2) percent of the total water pumped.

- Investment income decreased by 45.6% in 2003–2004, reflective of lower interest rates.
- The Corporation is in the second year of an economically sound three (3) year labor contract with the Corporation’s hourly unionized employees. The agreement with the Saginaw–Midland Water Supply System Employee’s Union covers the period 2003 through 2005.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual audit report includes this management’s discussion and analysis report, the independent auditor’s report and the basic financial statements of the Corporation. The financial statements also include notes that explain in more detail some of the information in the financial statements.

REQUIRED FINANCIAL STATEMENTS

The Corporation’s financial statements report information using accounting methods similar to those used by private sector companies. These statements offer short – and long-term financial information about its activities. The Statement of Net Assets includes all of the Corporation’s assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Corporation’s creditors (liabilities). It also provides the basis for evaluating the capital structure of the Corporation and assessing the liquidity and financial flexibility of the Corporation.

All of the current years’ revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the Corporation’s operations over the past year and can be used to determine whether the Corporation has successfully recovered all its costs. The final required financial statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities and provides answers to the origins of income, its uses and changes in the cash balance during the reporting period.

FINANCIAL ANALYSIS OF THE CORPORATION

A summary of the Corporation’s Statement of Net Assets is presented in Table A-1.

Table A-1
Statement of Net Assets - Summary

| | <u>2003-2004</u> | <u>2002-2003</u> | <u>Dollar Change</u> | <u>Percent Change</u> |
|---|-------------------------|-------------------------|---------------------------------|----------------------------------|
| Total Current Assets | \$291,798 | \$292,740 | (\$942) | -0.32% |
| Total Restricted Assets | \$1,258,546 | \$1,304,606 | (\$46,060) | -3.53% |
| Net Property, Plant and Equipment | \$36,817,763 | \$37,541,191 | (\$723,428) | -1.93% |
| Deferred Bond Issue Costs | \$310,603 | \$337,350 | (\$26,747) | -7.93% |
| Total Assets | \$38,678,710 | \$39,475,887 | (\$797,177) | -2.02% |
| Total Current Liabilities | \$1,577,130 | \$1,527,573 | \$49,557 | 3.24% |
| Total Long Term Debt | \$21,831,982 | \$22,958,423 | (\$1,126,441) | -4.91% |
| Post Retiree Health Cost - Funded | \$112,965 | \$95,493 | \$17,472 | 18.30% |
| Total Liabilities | \$23,522,077 | \$24,581,489 | (\$1,059,412) | -4.31% |
| Invested in Capital Assets, Net of Related Debt | \$13,620,781 | \$13,267,768 | \$353,013 | 2.66% |
| Restricted for Improvement & Emergency Repair | \$1,145,581 | \$1,209,113 | (\$63,532) | -5.25% |
| Unrestricted Assets | \$390,271 | \$417,517 | (\$27,246) | -6.53% |
| Total Net Assets | \$15,156,633 | \$14,894,398 | \$262,235 | 1.76% |

As can be seen from Table A-1, net assets increased \$262,235 to \$15,156,633 in 2003-2004 from \$14,894,398 in 2002-2003. The Improvement & Emergency Repair Fund decreased due to the budgeted rebuild of Pump #5 at the Whitestone Pumping Station as well as emergency intake and pipeline repairs. Funding continues by the owner cities at a level of \$.01 per 1000 gallons delivered. The Post Retiree Health Cost Fund continues to be funded by the owner cities at a level of \$.001 per 1000 gallons delivered.

Table A-2
Statement of Revenues, Expenses and Changes in Net Assets - Summary

| | <u>2003-2004</u> | <u>2002-2003</u> | <u>Dollar Change</u> | <u>Percent Change</u> |
|---------------------------------------|-------------------------|-------------------------|---------------------------------|----------------------------------|
| Operating Revenues - Water Sales | \$4,522,381 | \$4,180,746 | \$341,635 | 8.17% |
| Operating Expenses | \$2,868,038 | \$2,692,777 | \$175,261 | 6.51% |
| Operating Income | \$1,654,343 | \$1,487,969 | \$166,374 | 11.18% |
| Net Non-Operating Revenues (Expenses) | (\$1,392,108) | (\$1,189,971) | (\$202,137) | 16.99% |
| Changes in Net Assets | \$262,235 | \$297,998 | (\$35,763) | |
| Beginning Net Assets | \$14,894,398 | \$14,596,400 | \$297,998 | |
| Ending Net Assets | \$15,156,633 | \$14,894,398 | \$262,235 | |

While the Statement of Net Assets (Table A-1) shows the change in financial position of net assets, the Statements of Revenues, Expenses, and Changes in Net Assets (Table A-2) provides answers as to the nature and source of these changes. The Corporation operates with one fund, an enterprise fund on a full accrual basis of accounting similar

to private sector companies. The income is recognized when earned and the expense is recognized when incurred. Operating revenues are directly related to operating expenses. The Corporation closes its books at the end of each month and prepares financial reports and billings to its owners and customers such that all costs are covered. As can be seen in Table A-2 above, operating expenses increased in 2003-2004 by \$175,261, most of which was due to the retirement of the Manager, an overlap of managers during training, and increased labor related expenses.

BUDGETARY HIGHLIGHTS

The Corporation adopts an annual Operating Budget following review by the Board of Trustees. The Operating Budget includes proposed expenses and anticipated water sales. Each quarter, the Manager provides a Budget Position Statement for the Board's review where actual expenditures are compared to budgeted funds for each account. The Corporation's operating budget remains in effect the entire year. The 2003-2004 budget was revised to reflect retirement/hiring of the Corporation's Manager and the overlap of the managers during training. The Corporation has never operated over its approved budget and maintains a philosophy of only spending funds that are regarded as necessary. A budget comparison and analysis is presented in Table A-3.

Table A-3

Budget Comparison and Analysis

| <u>Year</u> | <u>Budgeted Expense</u> | <u>Actual Expense</u> | <u>Percent Under</u> |
|-------------|-----------------------------|---------------------------|--------------------------|
| 2004-2005 | \$4,882,835 | NA | |
| 2003-2004 | \$4,870,883 | \$4,527,326 | 7.05% |
| 2002-2003 | \$4,541,307 | \$4,186,334 | 7.82% |
| 2001-2002 | \$4,655,605 | \$4,431,505 | 4.81% |

The Board of Trustees and management of the Corporation consider many factors when setting the fiscal year budget. In 2003-2004 the non-operating revenue variance is actual investment income under budget. The water sold was under budget by seven (7) percent, while expenses were also held at seven (7) percent under budget. Most of the expense savings were accrued in purchased electrical energy.

CAPITAL ASSETS

At the end of 2004, the Corporation had \$36,817,763 invested in capital assets including the Water System (Whitestone Pumping Station, Pinconning Booster Station, Junction Booster Station, and complete underground distribution system) as well as

other assets as shown in Table A-4. There were no additions or deletions to the Water System or Furniture and fixtures during 2003-2004. The increase in machinery & equipment and vehicles is reflective of recognizing asset upgrades. During 2003-2004 the Corporation completed the complete refurbishing of Pump #5 at the Whitestone Pumping Station and completed emergency pipeline and extensive intake repairs.

Table A-4
Capital Assets

| | <u>2003-2004</u> | <u>2002-2003</u> | <u>Dollar Change</u> | <u>Percent Change</u> |
|-------------------------------|----------------------------|----------------------------|---------------------------------|----------------------------------|
| Capital Assets | | | | |
| Water System | \$58,393,126 | \$58,393,126 | \$0 | 0.00% |
| Furniture and Fixtures | \$14,925 | \$14,925 | \$0 | 0.00% |
| Vehicles | \$82,525 | \$83,073 | (\$548) | -0.66% |
| Machinery and Equipment | \$465,664 | \$442,289 | \$23,375 | 5.29% |
| Total Capital Assets | <u>\$58,956,240</u> | <u>\$58,933,413</u> | <u>\$22,827</u> | <u>0.04%</u> |
| Less Accumulated Depreciation | <u>\$22,138,477</u> | <u>\$21,392,222</u> | <u>\$746,255</u> | <u>3.49%</u> |
| Net Capital Assets | <u><u>\$36,817,763</u></u> | <u><u>\$37,541,191</u></u> | <u><u>(\$723,428)</u></u> | <u><u>-1.93%</u></u> |

The Corporation's five-year Capital Plan includes improvements to the Junction Station yard piping and electrical system reliability at the Whitestone Pumping Station. Also included in the Capital Plan is the replacement of disinfection systems, GPS location methodologies, and improvements to security measures

DEBT ADMINISTRATION

General obligation indebtedness outstanding at June 30, 2004 amounted to \$21,831,982. Interest on these bonds is payable semi-annually. More detailed information about the Corporation's long-term liabilities is presented in note 5 of the financial statements.

WATER RATES

Wholesale Water

The Corporation evaluates water rates charged to its five (5) municipal customers every 3 years. The most recent rate study was undertaken in 2003 and the results confirmed that the current rates are fair and equitable to both parties. The water rate design was developed on the "utility basis" of rate making as recommended in the American Water Works Association's Manual of Water Supply Practices M-1, entitled "*Principles of Water Rates, Fees, and Charges*," Fifth Edition, 2000. Details of the water rate design are based on the *Modified Base-Extra Capacity Method*, which most appropriately assigns equitable charges to recover the full cost of water service to the Corporation.

Owner City Costs

The owners of the Corporation purchase their water each month on a cost basis. The real test of the effectiveness of management and the efficiency of the operation is a review of the cost per 1000 gallons of water delivered to the owner cities. The cost of water includes operating expense, improvement and emergency repair expense, bond interest, loss on early retirement of debt, and depreciation less other income. The net expense for raw water delivered has been computed as shown Table A-5.

| Table A-5 | | | | | |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| Millions of Gallons Pumped | | | | | |
| <u>Year ended June 30,</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> |
| City of Saginaw | 8,840.66 | 9,459.38 | 9,495.97 | 9,198.32 | 9,506.62 |
| City of Midland | <u>8,186.54</u> | <u>8,604.80</u> | <u>8,659.17</u> | <u>8,074.20</u> | <u>8,295.18</u> |
| | 17,027.20 | 18,064.18 | 18,155.14 | 17,272.52 | 17,801.80 |
| Expense Per 1000 Gallons Pumped | | | | | |
| <u>Year ended June 30,</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> |
| Net Expenses | \$0.2406 | \$0.2050 | \$0.2224 | \$0.2340 | \$0.2296 |

CORPORATION CONTACT INFORMATION

This financial report is designed to provide our customers and creditors with a general overview of the Corporation's finances and to demonstrate the Corporation's accountability for the funds it receives. Anyone having questions regarding this report or desiring additional information may contact: Michael Quinnell, Manager/Secretary-Treasurer, Saginaw-Midland Municipal Water Supply Corporation, 4678 S. Three Mile Road, Bay City, MI 48706 or by phone at 989-684-2220 or by email at office@sagmid.com.

Saginaw-Midland Municipal Water Supply Corporation
Water Supply Fund
Statement of Net Assets
June 30, 2004 and 2003

| Assets | June 30, | |
|-----------------------------------|------------|------------|
| | 2004 | 2003 |
| Current assets | | |
| Cash | \$ 100 | \$ 37,121 |
| Due from other governmental units | | |
| City of Saginaw | 87,053 | 76,058 |
| City of Midland | 75,907 | 61,903 |
| Others | 14,642 | 16,178 |
| Inventories | 74,727 | 74,727 |
| Prepaid expenses | 36,138 | 26,753 |
| Cafeteria Plan receivable | 3,231 | - |
| Total current assets | 291,798 | 292,740 |
| Noncurrent assets | | |
| Restricted assets | | |
| Retiree health benefits | | |
| Cash | 111,429 | 93,993 |
| Due from other governmental units | 1,536 | 1,500 |
| Improvement and emergency repair | | |
| Cash | 375,791 | 446,978 |
| Cash equivalents | 754,428 | 747,140 |
| Due from other governmental units | 15,362 | 14,995 |
| Total restricted assets | 1,258,546 | 1,304,606 |
| Property, plant and equipment | | |
| Water system | 58,393,126 | 58,393,126 |
| Furniture and fixtures | 14,925 | 14,925 |
| Vehicles | 82,525 | 83,073 |
| Machinery and equipment | 465,664 | 442,289 |
| | 58,956,240 | 58,933,413 |
| Less: accumulated depreciation | 22,138,477 | 21,392,222 |
| Net property, plant and equipment | 36,817,763 | 37,541,191 |
| Other assets | | |
| Deferred bond issue costs | 310,603 | 337,350 |
| Total noncurrent assets | 38,386,912 | 39,183,147 |
| Total assets | 38,678,710 | 39,475,887 |

See Accompanying Notes to Financial Statements

Saginaw-Midland Municipal Water Supply Corporation

Water Supply Fund Statement of Net Assets June 30, 2004 and 2003

| | June 30, | |
|---|----------------------|----------------------|
| | 2004 | 2003 |
| Liabilities | | |
| Current liabilities | | |
| Current portion of bonds payable | \$ 1,365,000 | \$ 1,315,000 |
| Checks written against future deposits | 3,129 | - |
| Accounts payable | 1,612 | 2,351 |
| Accrued power | 61,399 | 61,665 |
| Accrued vacation and sick pay | 145,800 | 145,300 |
| Accrued pension costs | - | 2,977 |
| Accrued payroll | 190 | 280 |
| Total current liabilities | <u>1,577,130</u> | <u>1,527,573</u> |
| Noncurrent liabilities | | |
| Long term debt | | |
| Bonds payable, net of current portion | 22,000,000 | 23,365,000 |
| Less unamortized discount on 1992 bond issue | - | (3,000) |
| Less unamortized discount on 1998 bond issue | (48,100) | (274,434) |
| Less deferred amount on refunding 2002 bond issue | <u>(119,918)</u> | <u>(129,143)</u> |
| Total long term debt | 21,831,982 | 22,958,423 |
| Post retiree health cost - funded | <u>112,965</u> | <u>95,493</u> |
| Total noncurrent liabilities | <u>21,944,947</u> | <u>23,053,916</u> |
| Total liabilities | <u>23,522,077</u> | <u>24,581,489</u> |
| Net Assets | | |
| Invested in capital assets, net of related debt | 13,620,781 | 13,267,768 |
| Restricted for improvement and emergency repair | 1,145,581 | 1,209,113 |
| Unrestricted | <u>390,271</u> | <u>417,517</u> |
| Total net assets | <u>\$ 15,156,633</u> | <u>\$ 14,894,398</u> |

See Accompanying Notes to Financial Statements

Saginaw-Midland Municipal Water Supply Corporation
Water Supply Fund
Statement of Revenues, Expenses
and Changes in Net Assets
Year Ended June 30, 2004 and 2003

| | Year Ended June 30, | |
|--|------------------------|---------------|
| | 2004 | 2003 |
| Operating revenues | | |
| Water sales | | |
| City of Saginaw | \$ 2,297,900 | \$ 2,122,211 |
| City of Midland | 2,059,857 | 1,879,337 |
| Other water sales | 164,624 | 179,198 |
| Total operating revenues | 4,522,381 | 4,180,746 |
| Operating expenses | | |
| Water supply expenses | 2,105,509 | 1,933,261 |
| Depreciation | 762,529 | 759,516 |
| Total operating expenses | 2,868,038 | 2,692,777 |
| Operating income | 1,654,343 | 1,487,969 |
| Nonoperating revenues (expenses) | | |
| Miscellaneous income | 3,031 | 1,932 |
| Interest on investments | 1,989 | 3,654 |
| Improvement and emergency repair revenue | 177,562 | 189,986 |
| Gain (loss) on sale of property, plant and equipment | 5,448 | 6,864 |
| Bond interest expense | (1,078,588) | (1,119,304) |
| Loss on early retirement of debt | (260,455) | (260,455) |
| Improvement and emergency repair expenses | (241,095) | (12,648) |
| Net nonoperating revenues (expenses) | (1,392,108) | (1,189,971) |
| Increase in net assets | 262,235 | 297,998 |
| Net Assets | | |
| Net assets, beginning of year | 14,894,398 | 14,596,400 |
| Net assets, end of year | \$ 15,156,633 | \$ 14,894,398 |

See Accompanying Notes to Financial Statements

Saginaw-Midland Municipal Water Supply Corporation

Water Supply Fund

Statement of Cash Flows

Year Ended June 30, 2004 and 2003

| | Year Ended June 30, | |
|--|------------------------|---------------------|
| | 2004 | 2003 |
| Cash flows from operating activities | | |
| Water sales | \$ 4,498,515 | \$ 4,199,529 |
| Payment to suppliers | (1,469,420) | (1,475,486) |
| Payment to employees | (622,401) | (577,706) |
| Net cash provided by operating activities | <u>2,406,694</u> | <u>2,146,337</u> |
| Cash flows from non-capital financing activities | | |
| Cash funding of post retirement liability | 17,472 | 18,791 |
| Proceeds from salvage and miscellaneous | 3,031 | 1,932 |
| Net cash provided from non-capital financing activities | <u>20,503</u> | <u>20,723</u> |
| Cash flows from capital and related financing activities | | |
| Proceeds from sale of capital assets | 7,568 | 11,101 |
| Acquisition and construction of capital assets | (41,221) | (48,653) |
| Principal paid on bonds and notes payable | (1,315,000) | (950,000) |
| Interest paid less bond discounts on bonds payable | (1,100,484) | (1,147,403) |
| Improvement and emergency repair - net | (63,533) | 177,338 |
| Net cash used for capital and related financing activities | <u>(2,512,670)</u> | <u>(1,957,617)</u> |
| Cash flows from investing activities | | |
| Interest earned | 1,989 | 3,654 |
| Net increase (decrease) in cash and cash equivalents | (83,484) | 213,097 |
| Cash and cash equivalents, beginning of year | 1,325,232 | 1,112,135 |
| Cash and cash equivalents, end of year | <u>\$ 1,241,748</u> | <u>\$ 1,325,232</u> |
| Reconciliation of net operating revenues (expenses to net cash provided by (used in) operating activities: | | |
| Operating income | \$ 1,654,343 | \$ 1,487,969 |
| Noncash items included in operating income | | |
| Depreciation | 762,529 | 759,516 |
| (Increase) decrease in | | |
| Due from other governmental units | (23,866) | 18,783 |
| Prepaid expenses | (9,385) | (3,958) |
| Cafeteria plan receivable | (3,231) | - |
| Other assets | 26,747 | (116,519) |
| (Decrease) increase in | | |
| Checks written against future deposits | 3,129 | - |
| Accounts payable | (739) | 370 |
| Accrued expenses | (2,833) | 176 |
| Net cash provided by operating activities | <u>\$ 2,406,694</u> | <u>\$ 2,146,337</u> |

See Accompanying Notes to Financial Statements

Saginaw-Midland Municipal Water Supply Corporation

Notes to Financial Statements

June 30, 2004

NOTE 1 - DESCRIPTION OF THE ENTITY

The Saginaw-Midland Municipal Water Supply Corporation is an Authority created by the City of Saginaw and the City of Midland under Act 233, Public Acts of Michigan, 1955. The Authority was created in 1964 for the purpose of acquiring and operating a new water supply system to supplement the existing joint system that had been in existence since 1946.

On May 16, 1985, the Saginaw-Midland Municipal Water Supply Corporation, the City of Saginaw and the City of Midland and the Board of Water Commissioners of the Saginaw-Midland Water Supply System entered into an agreement to consolidate the operation of the joint water system under the Saginaw-Midland Municipal Water Supply Corporation effective June 30, 1985. The agreement provides that ownership interest shall remain as 23/43rds for the City of Saginaw and 20/43rds for the City of Midland. On March 3, 1986, both the Cities of Saginaw and Midland adopted resolutions to abolish the Board of Water Commissioners of the Saginaw-Midland Water Supply System.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Saginaw-Midland Municipal Water Supply Corporation conform to accounting principles generally accepted in the United States of America applicable to state and local governments.

The following significant accounting policies were applied in the preparation of the accompanying financial statements:

THE REPORTING ENTITY

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board (GASB) for determining the various governmental organizations to be included in the reporting entity. The Saginaw-Midland Municipal Water Supply Corporation is the primary government, which has oversight responsibility and control over all activities. As required by accounting principles generally accepted in the United States of America, the financial statements of the reporting entity include those of the Saginaw-Midland Municipal Water Supply Corporation (the primary government) and do not include any other component within its financial statements.

The Saginaw-Midland Municipal Water Supply Corporation operates the water system generally known as the Saginaw-Midland Water Supply System. Ownership of the system, with the exception of the 1967 Saginaw extension, is divided as follows:

| | |
|-----------------|-------|
| City of Saginaw | 23/43 |
| City of Midland | 20/43 |

The Saginaw-Midland Municipal Water Supply Corporation is considered a joint venture with equity interest belonging to the City of Saginaw and the City of Midland. Both cities appoint three board members to the Corporation's Board of Trustees.

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

BASIS OF PRESENTATION

The financial activities of the Corporation are recorded within one fund, categorized and described as follows:

PROPRIETARY FUND

Enterprise Fund - The Enterprise Fund reports operations that provide services, which are financed primarily by user charges, or activities where periodic measurement of net income is appropriate for capital maintenance, public policy, management control or other purposes.

The accrual basis of accounting is used in recording Enterprise Fund transactions, whereby revenue is recognized when earned and expenditures are recognized when the related liabilities are incurred and certain measurement and matching criteria are met.

ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

For the purpose of the statement of cash flows, all highly liquid investments (including restricted assets) with a maturity of 90 days or less when purchased are considered to be cash equivalents.

DUE FROM OTHER GOVERNMENT UNITS

Due from other government units have been recognized for all significant amounts due to the Corporation. Allowances for uncollectible accounts have not been provided because management does not consider collection doubtful, and feels any uncollected amounts would be immaterial.

INVENTORY

Inventories are valued at cost using the first-in, first-out method.

PROPERTY, PLANT AND EQUIPMENT

Building improvements greater than \$75,000 and equipment, furniture and vehicles greater than \$1,000 are capitalized at the time the costs are incurred. Depreciation is provided using the straight-line method for these capital assets, based on the estimated useful lives, commencing at the time the capital assets are put into operation.

COST OF BORROWING

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

SIGNIFICANT CONCENTRATION OF CREDIT RISK

Financial instruments, which potentially subject the Corporation to concentrations of credit risk, consist principally of cash and cash equivalents. The Corporation invests temporary cash in money market securities in various banks and securities backed by the United States Government. Amounts invested in a single institution are limited to minimize risk. The Corporation evaluates the institutions that they place cash and cash equivalents in for financial stability and monitor them on a continuous basis.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD

In accordance with GASB Statement 20, the Corporation has elected not to apply the FASB statements and interpretations issued after November 30, 1989, to its financial statements.

NOTE 3 - CASH AND CASH EQUIVALENTS

Deposits - The Corporation is authorized by the State statute to deposit its funds in banks, savings and loan associations, or credit unions having their principal offices in the State of Michigan. The carrying amounts at year end of the Corporation's deposits with financial institutions (excluding petty cash of \$100) was \$487,220. Of this amount \$487,220 is restricted.

The actual bank balances amounted to \$492,456. Of this amount, \$100,000 was insured by the FDIC and \$392,456 was uninsured and uncollateralized.

The Corporation believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Corporation evaluates each institution it deposits funds with and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Cash Equivalents - The Corporation is authorized by State of Michigan Act 217 of 1982 to invest in the following:

- a. Bonds, bills or notes of the United States; obligations, the principal and interest of which are fully guaranteed by the United States, or obligations of the state.
- b. Certificates of deposit issued by a state or national bank, savings accounts of a state or federal savings and loan association, or certificates of deposit or share certificates of a state or federal credit union organized and authorized to operate in this state.
- c. Commercial paper rated prime at the time of purchase and maturing not more than 270 days after the date of purchase.
- d. Securities issued or guaranteed by agencies or instrumentalities of the United States government.
- e. United States government or federal agency obligation repurchase agreements.
- f. Bankers acceptances issued by a bank that is a member of the federal deposit insurance corporation.
- g. Mutual funds composed entirely of investment vehicles that are legal for direct investment by a corporation.

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

The Corporation's cash equivalents are categorized to give an indication of the level of risk assumed by the Corporation at June 30, 2004. The categories are described as follows:

Category 1 – Insured or registered, with securities held by the entity or its agent in the entity's name.

Category 2 – Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name.

Category 3 – Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the entity's name.

| | <u>Category 3</u> | <u>Carrying Amount</u> | <u>Fair Value</u> |
|-----------------------|-----------------------|----------------------------|-----------------------|
| Cash equivalents | | | |
| Repurchase agreements | \$ 754,428 | \$ 754,428 | \$ 754,428 |

NOTE 4 - PROPERTY AND EQUIPMENT

The following table presents the changes in the various fixed assets class categories for the year ended June 30, 2004 as follows:

| | <u>Beginning Balance</u> | <u>Additions</u> | <u>Deletions</u> | <u>Ending Balance</u> |
|--------------------------------|------------------------------|------------------|------------------|---------------------------|
| Capital assets: | | | | |
| Water system | \$ 58,393,126 | \$ - | \$ - | \$ 58,393,126 |
| Furniture and fixtures | 14,925 | - | - | 14,925 |
| Vehicles | 83,073 | 17,846 | 18,394 | 82,525 |
| Machinery and equipment | 442,289 | 23,375 | - | 465,664 |
| Total capital assets | 58,933,413 | 41,221 | 18,394 | 58,956,240 |
| Less accumulated depreciation | | | | |
| Water system | 20,956,961 | 730,801 | - | 21,687,762 |
| Furniture and fixtures | 6,794 | 1,084 | - | 7,878 |
| Vehicles | 34,696 | 15,780 | 16,274 | 34,202 |
| Machinery and equipment | 393,771 | 14,864 | - | 408,635 |
| Total accumulated depreciation | 21,392,222 | \$ 762,529 | \$ 16,274 | 22,138,477 |
| Capital assets, net | \$ 37,541,191 | | | \$ 36,817,763 |

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

NOTE 5 - LONG-TERM DEBT

The following is a summary of long-term debt transactions for the year ended June 30, 2004.

| | Balance July 1, 2003 | Additions (Reductions) | Balance June 30, 2004 |
|--|----------------------------|---------------------------|-----------------------------|
| Bonds payable - joint project- issue 1992 - 6.4% due 9/1/2004 | \$ 250,000 | \$ (100,000) | \$ 150,000 |
| Bonds payable - joint project issue 1998 - 4.25% to 5% due 9/1/2016 | 13,250,000 | (890,000) | 12,360,000 |
| Refunding bonds payable - joint project issue 2002 - 2.0% to 5.25% due 9/1/2016 | <u>11,180,000</u> | <u>(325,000)</u> | <u>10,855,000</u> |
| | 24,680,000 | <u>\$ (1,315,000)</u> | 23,365,000 |
| Less unamortized bond discounts | | | |
| 1992 bond issue | (3,000) | 3,000 | - |
| 1998 bond issue | (274,434) | 226,334 | (48,100) |
| 2002 bond issue | <u>(129,143)</u> | 9,225 | <u>(119,918)</u> |
| Total debt | 24,273,423 | | 23,196,982 |
| Less current portion | <u>1,315,000</u> | | <u>1,365,000</u> |
| Total long-term debt | <u>\$ 22,958,423</u> | | <u>\$ 21,831,982</u> |

Bonds payable at June 30, 2004 and 2003 are comprised of the following individual issues:

1992 Issue

On March 1, 1992, the Corporation issued \$7,500,000 Water Supply Revenue Bonds (Limited Tax General Obligation), Series 1992.

The bonds were issued under the provisions of Act 94, Public Acts of Michigan, 1933, as amended, Act 233, Public Acts of Michigan, 1955, as amended, and Ordinances No. 1, as amended, and Ordinance No. 92-1 of the Saginaw-Midland Municipal Water Supply Corporation (the Corporation) for the purpose of defraying the cost of acquiring and constructing enlargements and extensions to the Saginaw-Midland Water Supply System (the System). The bonds are payable solely from the net revenues of the System and any additions thereto, and a statutory first lien on said revenues has been established by said Ordinances, which lien is of equal standing with the lien established for the Corporation's Water Supply System Revenue Bonds, Series 1979, dated July 1, 1979, in the original principal amount of \$12,500,000. The Corporation has covenanted and agreed to fix and maintain at all times while any of such bonds shall be outstanding such rates for service furnished by the System as shall be sufficient to provide for payment of the necessary expenses of operation, maintenance and administration of the System, of the principal and interest on all of said bonds when due, therefor, and to provide for such other expenditures and funds for the System as are required by said Ordinances.

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

The net revenues of the System consist of certain contractual payments to be made to the Corporation by the City of Saginaw, Michigan and the City of Midland, Michigan (collectively the Cities) pursuant to a 1992 Revenue Contract Supplement, dated January 1, 1992 (the Contract). Pursuant to the Contract, the Cities are obligated to purchase water from the Corporation as a cost of operation of the water systems of each of the Cities. The Cities have pledged their limited tax full faith credit for the payment of their proportion of the contractual payments which includes the Cities' obligation to levy taxes, if necessary, within applicable constitutional, charter and statutory limitations for the payment of said contractual payments.

1998 Refunding Issue

On March 5, 1998, the corporation issued \$13,920,000 Water Supply Refunding Revenue Bonds (Limited Tax General Obligation), Series 1998.

The bonds are being issued under the provisions of Act 94, Public Acts of Michigan, 1933, as amended, Act 233, Public Acts of Michigan, 1995, as amended, and resolutions and ordinances (the "Resolutions") of the Saginaw-Midland Municipal Water Supply Corporation (the "Corporation") for the purpose of refunding a portion of the Corporation's Water Supply System Revenue Bonds, Series 1992 and the Corporation's Water Supply System Refunding Revenue Bonds, Series 1992 (together the "prior Bonds"). The Bonds are payable solely from net revenues of the Saginaw Midland Water Supply System (the "System") and any addition is thereto, and a statutory first lien on said revenues has been established by the Resolutions. The Corporation has covenanted and agreed to fix and maintain at all times while any of the Bonds shall be outstanding such rates for service furnished by the System as shall be sufficient to provide for payment of the necessary expenses of operation, maintenance and administration of the System, payment of the principal and interest on all of the Bonds when due, and to provide for such other expenditures and funds for the System as are required by said Resolutions.

The net revenues of the System consist of certain contractual payments to be made to the Corporation by the City of Saginaw, Michigan and the City of Midland, Michigan (collectively the "Cities") pursuant to an amended contract (the "Contract"). Pursuant to the contract, the Cities are obligated to purchase water from the Corporation as a cost of operation of the water systems of each of the Cities. The Cities have pledged their limited tax full faith and credit for the payment of their proportion of the contractual payments which includes the Cities' obligation to levy taxes, if necessary, within applicable constitutional, statutory and charter limitations for the payment of said contractual payments. The Cities do not have the power to levy additional taxes in excess of their respective applicable constitutional, statutory and charter limitations for the payment of their contractual payments. The rights or remedies of bondholders may be affected by bankruptcy, insolvency, fraudulent conveyance or other laws affecting creditors' right generally, now existing or hereafter enacted, and by the application of general principles of equity including those relating to equitable subordination.

The 1998 Refunding Issue was used to advance refund \$6,925,000 of outstanding 1992 bonds and \$5,290,000 of outstanding 1992 refunding bonds. The net proceeds of \$13,606,465 (after payment of \$243,037 in underwriting fees and other bond issuance cost, and \$70,498 of bond discounts) were used to purchase U.S. treasury securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future payments on the 1992 bonds and 1992 refunding bonds. The 1992 bonds are callable on September 1, 2004 and the 1992 refunding bonds are callable on May 1, 2002. As a result, these bonds are considered to be defeased and the liability for those bonds has been removed. At June 30, 2004 \$12,215,000 of bonds outstanding are considered defeased.

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

2002 Refunding Issue

On September 1, 2002, the corporation issued \$11,180,000 Water Supply Refunding Revenue Bonds (Limited Tax General Obligation), Series 2002.

The bonds are being issued under the provisions of Act 94, Public Acts of Michigan, 1933, as amended, Act 233, Public Acts of Michigan, 1995, as amended, Act 34, Public Acts of Michigan, 2001, as amended, and resolutions and ordinances (the "Bond Authorization") of the Saginaw-Midland Municipal Water Supply Corporation (the "Corporation") for the purpose of refunding the Corporation's outstanding Water Supply System Revenue Bonds (Limited Tax general Obligation), Series 1993 (the "Prior Bonds"). The Bonds are payable solely from net revenues of the Saginaw Midland Water Supply System (the "System") and any addition is thereto, and a statutory first lien on such revenues has been established by the Bond Authorization. The Corporation has covenanted and agreed to fix and maintain at all times while any of the Bonds shall be outstanding such rates for service furnished by the System as shall be sufficient to provide for payment of the necessary expenses of operation, maintenance and administration of the System, payment of the principal and interest on all of the Bonds when due, and to provide for such other expenditures and funds for the System as are required by the Bond Authorization.

The net revenues of the System consist of certain contractual payments to be made to the Corporation by the City of Saginaw, Michigan and the City of Midland, Michigan (collectively the "Cities") pursuant to an amended contract (the "Contract"). Pursuant to the Contract, the Cities are obligated to purchase water from the Corporation as a cost of operation of the water systems of each of the Cities. The Cities have pledged their limited tax full faith and credit for the payment of their proportion of the contractual payments which includes the Cities' obligation to levy taxes, if necessary, within applicable constitutional, statutory and charter limitations for the payment of the contractual payments. The rights or remedies of bondholders may be affected by bankruptcy, insolvency, fraudulent conveyance or other laws affecting creditors' right generally, now existing or hereafter enacted, and by the application of general principles of equity including those relating to equitable subordination.

The 2002 Refunding Issue was used to advance refund \$11,000,000 of outstanding 1993 bonds. The net proceeds of \$11,434,500 (after payment of \$174,441 in underwriting fees and other bond issuance cost) were used to purchase U.S. treasury securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future payments on the 1993 bonds. The 1993 bonds are callable on September 1, 2004. As a result, these bonds are considered to be defeased and the liability for those bonds has been removed. At June 30, 2004 \$11,000,000 of bonds outstanding are considered defeased. The refunding will save the Corporation approximately \$ 900,000 over the life of the bond issue.

Interest expense for the years ended June 30, 2004 and 2003 was \$1,078,588 and \$1,119,304, respectively.

The annual requirements to amortize the debt outstanding as of June 30, 2004 including interest payments of \$7,903,628 are as follows:

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

| Year Ended June 30, | Joint Project | | | Total |
|------------------------|-------------------|----------------------|----------------------|----------------------|
| | 1992 | 1998 | 2002 | |
| 2005 | \$ 154,800 | \$ 1,436,330 | \$ 795,915 | \$ 2,387,045 |
| 2006 | - | 1,589,518 | 799,115 | 2,388,633 |
| 2007 | - | 1,557,697 | 831,045 | 2,388,742 |
| 2008 | - | 1,529,570 | 860,050 | 2,389,620 |
| 2009 | - | 1,553,488 | 836,931 | 2,390,419 |
| 2010 | - | 1,549,037 | 843,119 | 2,392,156 |
| 2011 | - | 1,067,750 | 1,324,600 | 2,392,350 |
| 2012 | - | 1,019,500 | 1,401,650 | 2,421,150 |
| 2013 | - | 975,125 | 1,447,050 | 2,422,175 |
| 2014 | - | 935,875 | 1,487,494 | 2,423,369 |
| 2015 | - | 930,750 | 1,491,650 | 2,422,400 |
| 2016 | - | 933,625 | 1,491,038 | 2,424,663 |
| 2017 | - | 963,500 | 1,462,406 | 2,425,906 |
| | <u>\$ 154,800</u> | <u>\$ 16,041,765</u> | <u>\$ 15,072,063</u> | <u>\$ 31,268,628</u> |

NOTE 6 - RESTRICTED NET ASSETS

Detail of restricted net assets is as follows:

| | June 30, | |
|---|---------------------|---------------------|
| | 2004 | 2003 |
| Restricted in use for improvements and emergency repairs to the system | | |
| Saginaw | \$ 612,727 | \$ 646,709 |
| Midland | 532,854 | 562,404 |
| | <u>\$ 1,145,581</u> | <u>\$ 1,209,113</u> |

NOTE 7 - PENSION PLANS

DEFINED BENEFIT PLAN

PLAN DESCRIPTION

The Corporation participates in the Michigan Municipal Employees Retirement System (MMERS), an agent multiple-employer defined benefit pension plan that covers substantially all employees of the Corporation hired prior to February 1, 2000. The system provides retirement, survivor and disability benefits to plan members and their beneficiaries. The Michigan Municipal Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to the System at 1134 Municipal Way, Lansing, Michigan 48917.

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

FUNDING POLICY

The obligation to contribute to and maintain the system for these employees was established primarily by negotiation with the Corporation's collective bargaining unit, and requires a contribution from the employees of 3 percent of gross wages. The Corporation's funding policy provides for monthly employee and employer contributions at actuarially determined rates which amounted to 7.6% and 4.9% of covered payroll for the years ended June 30, 2004 and 2003, respectively.

ANNUAL PENSION COST

For years ended June 30, 2004 and 2003 the Corporation's annual pension cost of \$ 40,352 and \$ 23,598, respectively equaled the Corporation's required and actual contribution. Actuarial valuations of each participating municipality in the Municipal Employees' Retirement System are prepared annually to determine the actuarial condition of the Retirement System and the employer contribution rates required to fund MERS on an actuarial reserve basis. The calculated employer contribution rates derived from this actuarial valuation as of December 31, 2001 are based on the present provisions of the Municipal Employees' Retirement Act of 1984, as amended by 1996 Public Act 220, as embodied in the MERS Plan Document (as revised). Significant actuarial assumptions used include (a) an 8 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, compounded annually, attributable to inflation, and (c) additional projected salary increases of zero percent to 4.16 percent per year, attributable to seniority/merit. The actuarial value of assets was determined using techniques that smooth the effects of short term volatility over a four year period. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is 30 years.

THREE YEAR TREND INFORMATION

| <u>Year Ended June 30</u> | <u>Annual Pension Cost (APC)</u> | <u>Percentage of APC Contributed</u> | <u>Net Pension Obligation</u> |
|-----------------------------------|--|--|---------------------------------------|
| 2002 | \$ - | 100% | None |
| 2003 | 23,598 | 100% | None |
| 2004 | 40,352 | 100% | None |

SCHEDULE OF FUNDING PROGRESS

| <u>Actuarial Valuation Date</u> | <u>Actuarial Value of Assets</u> | <u>Actuarial Accrued Liability (AAL)</u> | <u>Unfunded AAL (UAAL)</u> | <u>Funded Ratio</u> | <u>Covered Payroll</u> | <u>APC as a Percent of Covered Payroll</u> |
|---|--|--|--------------------------------|-------------------------|----------------------------|--|
| 12/31/01 | \$ 2,493,254 | \$ 2,515,600 | \$ 22,346 | 99% | \$ 491,578 | 0% |
| 12/31/02 | 2,387,110 | 2,555,936 | 168,826 | 93% | 476,821 | 5% |
| 12/31/03 | 2,414,420 | 2,813,232 | 398,812 | 86% | 528,050 | 8% |

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

MONEY PURCHASE PLAN AND TRUST

The Corporation established the Saginaw-Midland Municipal Water Supply Corporation Manager Plan (Plan) effective January 1, 1999. The Plan is a defined contribution plan that is administered by the ICMA Retirement Corporation. The Plan's only eligible participant is the recently retired manager of the Corporation. The Board of Trustees of the Corporation has the right to amend or terminate the Plan. The Plan calls for monthly employer contributions of 10% of eligible employee salary, which amounted to \$6,461 and \$8,298 for the years ended June 30, 2004 and 2003, respectively.

DEFINED CONTRIBUTION PLAN

The Corporation participates in the Municipal Employees Retirement System of Michigan (MERS), in the form of the ICMA Retirement Corporation Governmental Money Purchase Plan and Trust, as amended and as authorized by Section 19A of the Municipal Employees' Retirement System of Michigan Plan Document. This defined contribution plan covers substantially all employees of the Corporation hired after January 31, 2000. The obligation to contribute to and maintain the system for these employees was established primarily by negotiation with the Corporation's collective bargaining unit and requires an employer contribution of 6% of covered payroll, while requiring zero percent contribution from the employee. In addition, the employer will match employee contributions of 3% of covered payroll for those employees who exercise the one time voluntary contribution election. For the year ended June 30, 2004 and 2003 the Corporation contributed \$7,793 and \$6,834 and employees contributed \$2,598 and \$2,278, respectively.

NOTE 8 - POST EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The Corporation provides post-retirement health coverage under its Blue Cross insurance plan to all salary employees and their qualified spouse hired prior to September 30, 1998. In addition, the Corporation provides post-retirement health coverage to the manager and qualified spouse of the Corporation hired in fiscal year 2004. All hourly employees continue to have post-retirement health care coverage with a co-pay component. This coverage becomes supplemental to Medicare coverage when the retired employee becomes eligible for Medicare. The estimated employer liability and funding as of June 30, is as follows:

| | <u>2004</u> | <u>2003</u> |
|---------------------|-------------------|-------------------|
| Estimated liability | \$ 1,106,831 | \$ 999,958 |
| Amount funded | <u>112,965</u> | <u>95,493</u> |
| Unfunded liability | <u>\$ 993,866</u> | <u>\$ 904,465</u> |

The corporation had seventeen retirees qualifying for post-retirement health care coverage at June 30, 2004 and 2003. The cost to the Corporation of providing post-retirement health care coverage for its retirees for the years ended June 30, 2004 and 2003 on a pay-as-you-go basis was \$100,977 and \$82,790, respectively.

Saginaw-Midland Municipal Water Supply Corporation
Notes to Financial Statements
June 30, 2004

NOTE 9 - ECONOMIC DEPENDENCY

Saginaw-Midland Municipal Water Supply Corporation was created to supply water to the Cities of Saginaw and Midland. The water requirements of the Cities are directly related to those of the larger area businesses, which are subject to the general economy of the area. The Corporation's sales to the Cities for the years ended June 30, 2004 and 2003 were \$4,357,755 and \$4,001,548, respectively. These represent 96%, of the total operating revenue. The Corporation's receivables from the Cities at June 30, 2004 and 2003 were \$162,960 and \$137,961, respectively. These represent 92% and 90%, of the total receivable balance, respectively.

Saginaw-Midland Municipal Water Supply Corporation
Schedule of Indebtedness
June 30, 2004

| | Date of Issue | Amount of Issue | Interest Rate | Date of Maturity | Amount of Annual Maturity | June 30, 2004 |
|--|------------------|--------------------|------------------|---------------------|---------------------------------|----------------------|
| 1992 Bond Issue (Joint Project) | 3/1/1992 | \$7,500,000 | 6.40% | 9/1/04 | \$ 150,000 | <u>\$ 150,000</u> |
| 1998 Refunding Bond Issue (Joint Project) | 3/5/1998 | 13,920,000 | 4.25% | 9/1/2004 | 880,000 | 880,000 |
| | | | 4.30% | 9/1/2005 | 1,075,000 | 1,075,000 |
| | | | 4.35% | 9/1/2006 | 1,090,000 | 1,090,000 |
| | | | 4.40% | 9/1/2007 | 1,110,000 | 1,110,000 |
| | | | 4.50% | 9/1/2008 | 1,185,000 | 1,185,000 |
| | | | 4.50% | 9/1/2009 | 1,235,000 | 1,235,000 |
| | | | 4.63% | 9/1/2010 | 800,000 | 800,000 |
| | | | 5.00% | 9/1/2011 | 790,000 | 790,000 |
| | | | 5.00% | 9/1/12-13 | 785,000 | 1,570,000 |
| | | | 5.00% | 9/1/2014 | 820,000 | 820,000 |
| | | | 5.00% | 9/1/2015 | 865,000 | 865,000 |
| | | | 5.00% | 9/1/2016 | 940,000 | <u>940,000</u> |
| | | | | | | <u>12,360,000</u> |
| 2002 Refunding Bond Issue (Joint Project) | 12/19/2002 | 11,180,000 | 2.00% | 9/1/2004 | 335,000 | 335,000 |
| | | | 2.00% | 9/1/2005 | 345,000 | 345,000 |
| | | | 2.40% | 9/1/2006 | 385,000 | 385,000 |
| | | | 3.00% | 9/1/2007 | 425,000 | 425,000 |
| | | | 3.25% | 9/1/2008 | 415,000 | 415,000 |
| | | | 3.25% | 9/1/2009 | 435,000 | 435,000 |
| | | | 3.50% | 9/1/2010 | 940,000 | 940,000 |
| | | | 5.00% | 9/1/2011 | 1,060,000 | 1,060,000 |
| | | | 4.00% | 9/1/2012 | 1,155,000 | 1,155,000 |
| | | | 4.25% | 9/1/2013 | 1,245,000 | 1,245,000 |
| | | | 5.25% | 9/1/2014 | 1,310,000 | 1,310,000 |
| | | | 5.25% | 9/1/2015 | 1,380,000 | 1,380,000 |
| 5.25% | 9/1/2016 | 1,425,000 | <u>1,425,000</u> | | | |
| | | | | | | <u>10,855,000</u> |
| | | | | | | <u>\$ 23,365,000</u> |

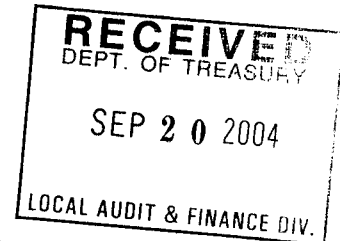
Saginaw-Midland Municipal Water Supply Corporation
Schedule of Financial Highlights

| | Year Ended June 30, | | | |
|---|---------------------|---------------------|---------------------|---------------------|
| | 2004 | 2003 | 2002 | 2001 |
| Millions of Gallons Pumped | | | | |
| City of Saginaw | 8,840.86 | 9,459.38 | 9,495.97 | 9,198.32 |
| City of Midland | 8,186.54 | 8,604.80 | 8,659.17 | 8,074.20 |
| | <u>17,027.40</u> | <u>18,064.18</u> | <u>18,155.14</u> | <u>17,272.52</u> |
| Expenses | | | | |
| Operating expenses | \$ 2,105,509 | \$ 1,933,261 | \$ 1,974,322 | \$ 1,804,227 |
| Improvement and emergency repair expenses | 241,095 | 12,648 | 80,045 | 32,595 |
| Bond interest | 1,078,588 | 1,119,304 | 1,408,111 | 1,469,916 |
| Loss on early retirement of debt | 260,455 | 260,455 | 222,634 | 222,634 |
| Depreciation | 762,529 | 759,516 | 758,790 | 799,190 |
| Total expenses | 4,448,176 | 4,085,184 | 4,443,902 | 4,328,562 |
| Less other income | 352,654 | 381,634 | 407,176 | 288,843 |
| Net expenses | <u>\$ 4,095,522</u> | <u>\$ 3,703,550</u> | <u>\$ 4,036,726</u> | <u>\$ 4,039,719</u> |
| Expense Per 1,000 Gallons Pumped | | | | |
| Operating expenses | \$ 0.1237 | \$ 0.1070 | \$ 0.1087 | \$ 0.1045 |
| Improvement and emergency repair expenses | 0.0142 | 0.0007 | 0.0044 | 0.0019 |
| Bond interest | 0.0633 | 0.0620 | 0.0776 | 0.0851 |
| Loss on early retirement of debt | 0.0153 | 0.0144 | 0.0123 | 0.0129 |
| Depreciation | 0.0448 | 0.0420 | 0.0418 | 0.0463 |
| Total expenses | 0.2613 | 0.2261 | 0.2448 | 0.2507 |
| Less other income | 0.0207 | 0.0211 | 0.0224 | 0.0167 |
| Net expenses | <u>\$ 0.2406</u> | <u>\$ 0.2050</u> | <u>\$ 0.2224</u> | <u>\$ 0.2340</u> |



July 15, 2004

Board of Directors
Saginaw-Midland Municipal
Water Supply Corporation
Bay City, Michigan



In planning and performing our audit of the financial statements of Saginaw-Midland Municipal Water Supply Corporation for the year ended June 30, 2004, we considered the Corporation's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control system.

However, during our audit we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The following summarizes our comments and suggestions regarding those matters. This letter does not affect our report dated July 15, 2004, on the financial statements of Saginaw-Midland Municipal Water Supply Corporation.

BANK RECONCILIATIONS

Due to the size of the Corporation all accounting functions are performed by the same individual. However, we noted the Manager and Board of Directors are very involved in check and invoice approval. An additional safeguard which could be easily implemented with no cost to the Corporation would be to have the Manager receive unopened bank statements and review prior to reconciliations being performed. We further recommend the Manager review all bank reconciliations for accuracy and agreement to the general ledger and initial the bank reconciliation noting the review. Implementing these recommendations would improve internal controls over the bank reconciliation process.

CODE OF CONDUCT

During fieldwork we noted the Corporation did not have a code of conduct policy with regard to fraud. A policy such as this will help to prevent and detect fraud. Therefore, we recommend the Corporation establish a fraud code of conduct policy to educate its employees on the Corporation's stance on fraud. The policy should include but is not limited to:

- The Corporation has a zero tolerance policy
- Actions which are considered to be fraud
- Chain of command in case of suspicion

This report is intended solely for the information and use of the board of directors, management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

July 15, 2004

Board of Directors
Saginaw-Midland Municipal
Water Supply Corporation

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with various Agency personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Very Truly Yours

Yeo & Yeo, P.C.
CPAs and Business Consultants

A handwritten signature in black ink, reading "Thomas E. Hollerback". The signature is written in a cursive style with a long, sweeping underline.

Thomas E. Hollerback